United States Bankruptcy Court
Northern District of Texas
1100 Commerce Street, Suite 12A24
Dallas, Texas 75242

Chambers of
Barbara J. Houser
United States Bankruptcy Judge

Telephone
(214) 753-2055

January 18, 2002

J. Robert Forshey, Esq.
Forshey & Prostock, LLP
777 Main St., Suite 1285
Fort Worth, TX 76102

Via Facsimile and U.S. Mail
817/877-4151

Richard W. Ward, Esq.
2527 Fairmount St.
Dallas, TX 75201

Via Facsimile and U.S. Mail
214/871-2682

Mark J. Petrocchi
Colvin & Petrocchi, L.L.P.
801 Cherry St., Ste. 1035
Ft. Worth, TX 76102-6810

Via Facsimile and U.S. Mail
817/338-9209

Re: *In Re: Robert J. Hutchison*, Case No. 01-46374-BJH-11

Dear Counsel:

Before the Court is the Motion for Order Enforcing Automatic Stay and Awarding Damages for Violation of the Automatic Stay (the "Motion") filed by Robert J. Hutchison (the "Debtor") on November 30, 2001. In the Motion, the Debtor seeks a determination that certain actions of Ciarletta & Associates, Inc. ("Ciarletta") constitute willful violations of the automatic stay and that the Debtor is entitled to damages for such stay violations. Ciarletta filed a response to the Motion on December 28, 2001 (the "Response"). At the conclusion of the January 3, 2002 hearing, the Court took the Motion under advisement. Thereafter, both parties filed supplemental briefs and the Debtor filed a reply to Ciarletta's supplemental brief. This letter states the Court's findings of fact and conclusions of law on the Motion.

After careful consideration of the Motion, the Response, the supplemental and reply briefs, the evidence presented at the hearing, and the arguments of counsel, the Court concludes that the Motion should be granted. The Court's analysis is set forth below.

I. Factual Background

The Debtor commenced this case on August 31, 2001. The Debtor owns at least 90% of the shares of stock (the "Shares") in Texas Raceways, Inc. ("TRI"). TRI is also a chapter 11 debtor in this Court, having commenced its case on August 31, 2001. At the time of the bankruptcy filings, the Debtor was the president and sole director of TRI. TRI operates a drag racing strip in Kennedale, Texas.

Prepetition, the Debtor and TRI entered into various agreements with Ciarletta which related to Ciarletta's offer to purchase TRI from the Debtor. One of these documents was a Voting Trust Agreement. The effect of this Voting Trust Agreement is at the heart of the parties' dispute. If properly documented and consummated, the Voting Trust Agreement grants Ciarletta the power to vote the Shares under certain circumstances. After the Voting Trust Agreement was executed, Ciarletta took possession of the Shares. However, the Shares were never transferred into Ciarletta's name.

On November 7, 2001, without seeking relief from the automatic stay, Ciarletta held a shareholders meeting pursuant to the Voting Trust Agreement. At this meeting, Ciarletta voted the Shares to remove the Debtor as the president and sole director of TRI and to elect Jack Ciarletta to those offices.

The Debtor contends that these actions violated the automatic stay because the Shares are property of the Debtor's bankruptcy estate and Ciarletta acted to exercise control over that property. Specifically, the Debtor contends that his right to serve as the president and sole director of TRI while it is a debtor in possession is a valuable right protected by the automatic stay. Because the Shares were never transferred into Ciarletta's name, the Debtor contends that Ciarletta had no right to call a shareholder's meeting or vote the Shares under Texas state law. Ciarletta disagrees and contends that possession of the Shares was sufficient to enable it to exercise its rights under the Voting Trust Agreement and that it was simply exercising its corporate governance rights by calling a shareholder's meeting and electing Jack Ciarletta as the president and sole director of TRI.

II. Discussion

Upon the Debtor's filing of his voluntary petition under chapter 11, section 362(a) of the Bankruptcy Code stayed all "entities" from "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate." 11 U.S.C. § 362(a)(3). Thus, the first question the Court must decide is whether the Shares are property of the Debtor's bankruptcy estate. Section 541 of the Code defines what constitutes "property of the estate" and provides that:

> Such estate is comprised of all the following property, *wherever located and by whomever held*:
> (1) . . . all legal or equitable interests of the debtor in property as of the commencement of the case.

11 U.S.C. § 541(a)(emphasis added).

The Debtor's stock ownership in TRI as evidenced by the Shares is clearly property of his bankruptcy estate. When Ciarletta called the shareholder's meeting and exercised the right to vote the Shares, it did so at a time when the automatic stay was in effect in the Debtor's case. At a minimum, Ciarletta's attempt to vote the Shares to remove the Debtor as an officer and director of TRI was an attempt to exercise control over property of the Debtor's estate – *i.e.*, the Shares and the rights attendant to ownership of the Shares. There is no question that Ciarletta's ultimate goal was to gain control over the chapter 11 reorganization of TRI, as it voted to remove the Debtor as the controlling officer and director of TRI. The automatic stay protected the Debtor from removal as the controlling officer of TRI absent the lifting of the automatic stay or the appointment of a chapter 11 trustee, after notice to other parties in interest in the Debtor's case and hearing. This conclusion is consistent with the decisions of various other courts which have addressed this issue.[1] *See, e.g.*, *In re Country Estates Nursing Home, Inc.*, 268 B.R. 316 (Bankr. D. Mass. 2001); *In re Marvel Entm't Group, Inc.*, 209 B.R. 832 (D. Del. 1997) (in *dictum*); *In re Fairmont Communications Corp.*, No. 92 B44861 (Bankr. S.D.N.Y. March 3, 1993).

While Ciarletta argues that the effect of the Voting Trust Agreement is to vest ownership of the right to vote the Shares in it, the Court disagrees. Under the Voting Trust Agreement, Ciarletta has a contractual right to vote the Shares under certain circumstances and the Debtor retains the right to vote the Shares under other, admittedly more limited, circumstances. *See* Voting Trust Agreement, sec. 3. However, notwithstanding the contractual right provided by the Voting Trust Agreement, Texas state law requires that the Shares be transferred "into his name as trustee" before the right to vote is exercisable. *See* Tex. Bus. Corp. Act Ann. art. 2.29, §F (Vernon 1980). ("Shares standing in the name of a trustee may be voted by him, either in person or by proxy, *but no trustee shall be entitled to vote shares held by him without a transfer of such shares into his name as trustee.*") (emphasis added). While Ciarletta contends that the Debtor

[1] If only TRI was a chapter 11 debtor, and Hutchison, individually, had not filed for relief, the Court might well come to a different conclusion. Several courts have held that notwithstanding a pending chapter 11 proceeding for a corporation, shareholders of that corporation are entitled to exercise their corporate governance rights and hold shareholders' meetings without that action violating the automatic stay. *See e.g. Manville Corp. v. Equity Sec. Holders Comm. (In re Johns-Manville Corp.)*, 801 F.2d 60, 64 (2d Cir. 1986); *In re Potter Instrument Co., Inc.*, 593 F.2d 470, 475 (2d Cir. 1979). That conclusion is not particularly surprising because the shareholder's stock in the corporation is not property of the estate of the corporate debtor. Here, however, the sole (or at least 90%) shareholder of TRI is also a chapter 11 debtor in possession. Hutchison's ownership interest in TRI – *i.e.*, the Shares – are property of Hutchison's individual bankruptcy estate.

breached his various contracts with Ciarletta by refusing to transfer the Shares into Ciarletta's name, the fact remains that as of November 7, 2001, the date of the purported shareholder's meeting, the Shares were not held by Ciarletta in his name. Rather, the Shares remained in the name of the Debtor. In the Court's view, Ciarletta's argument places undue emphasis on the characterization of the right to vote the Shares - *i.e.*, on whether or not the right to vote is property of the estate. The real issue is whether or not *the Shares* are property of the estate. Frankly, even if, as Ciarletta contends, the right to vote the Shares is vested in it by virtue of the Voting Trust Agreement, it is undisputed that record ownership of the Shares themselves remains to this date with the Debtor, and the Shares are therefore property of the estate. Accordingly, Ciarletta's acts were acts to "exercise control over property of the estate" within the meaning of 11 U.S.C. § 362(a)(3). *In re Country Estates Nursing Home, Inc.*, 268 B.R. 316. Ciarletta's attempt to distinguish the *Country Estates* case on the ground that it involved a stock pledge agreement, and not a voting trust agreement, is unpersuasive. The cases make clear that where the entity voting stock shares derives its ability to vote them from its status *as a creditor*, then traditional notions of corporate governance, which ordinarily allow shareholders to vote their shares to replace management notwithstanding the fact that a corporation is in bankruptcy, are not implicated. *See, e.g., In re Fairmont Communications Corp.*, No. 92 B44861. Rather, those cases hold that in such a situation, the automatic stay *is* implicated.

In an effort to avoid the literal requirements of article 2.29(F) of the Texas Business Corporation Act ("TBCA"), which state that a trustee may not vote shares which are not in the trustee's name, Ciarletta contends that the Court should interpret that provision in a manner consistent with article 2.22 of the TBCA and the provisions of Chapter 8 of the Texas Business and Commerce Code (the "Texas UCC"). *See* Tex. Bus. Corp. Act Ann. Art. 2.22 (Vernon 1980); Tex. Bus. & Com. Code Ann. §8.01 *et seq.* (Vernon 1987). Specifically, Ciarletta contends that the requirement of article 2.29(F) of the TBCA that the shares be transferred "into his name as trustee" be deemed to be satisfied by the trustee taking possession of the shares. Ciarletta argues that because (i) article 2.22 of the TBCA provides that shares of a corporation are personal property and are transferable in accordance with the provisions of Chapter 8 of the Texas UCC, (ii) shares are transferred by delivery and delivery occurs, in accordance with § 8.301(a)(1) of the Texas UCC, when the "purchaser acquires possession of the security certificate," and (iii) Ciarletta had possession of the Shares, that it had the right to call a shareholder's meeting and vote the Shares as it saw fit on November 7, 2001 – *i.e.*, to replace the Debtor as president and the sole director of TRI – without running afoul of the automatic stay.

The Court disagrees. To interpret article 2.29(F) as Ciarletta suggests ignores (i) the literal language of article 2.29(F), which clearly states that to vote such shares they must be transferred into the name of the trustee; (ii) the distinction that subsection makes itself between shares held by "an administrator, executor, guardian, or conservator," which can be voted by that person if the shares are in his possession, and a "trustee," who can only vote the shares if the shares are transferred "into his name as trustee;" (iii) the caveat in article 2.22(A) of the TBCA

which states that "except as otherwise provided in this Act," shares of a corporation are personal property and are transferable in accordance with Chapter 8 of the Texas UCC; and (iv) the fact that the provisions of Chapter 8 of the Texas UCC relied upon by Ciarletta deal with the rights of purchasers of certificated securities and Ciarletta is not in possession of the Shares as a purchaser.

The Debtor argues, for the first time in his supplemental papers, that section 2 of the Voting Trust Agreement requires that all certificates representing shares must be registered in the name of the trustee, and since such registration never took place, Ciarletta failed to satisfy a clear condition to the effectiveness of the Voting Trust Agreement. Ciarletta, however, correctly observes that the Voting Trust Agreement nowhere manifests such an intention. To the contrary, section 6 expressly provides that the term of the agreement was to commence on the date of its execution and that it remains in effect until certain specified debts are paid.

However, despite the Court's belief that the Voting Trust Agreement was effective notwithstanding the failure to register the Shares in the trustee's name, the outcome in this case remains unchanged, as there was still no compliance with Article 2.29(F) of the TBCA, which clearly requires that a trustee who wishes to actually vote shares subject to a voting trust have those shares transferred into his name. Ciarletta's prior counsel clearly understood the need to obtain the endorsement of the Shares before exercising voting rights under the Voting Trust Agreement. *See, e.g.,* Exhibit 4 (August 14, 2001 letter from Ciarletta's counsel which states that "Mr. Hutchison has failed or refused to provide the necessary endorsements of his stock certificates. As a result, CAI has been unable to exercise any rights under the Voting Trust Agreement or elect Jack M. Ciarletta as a director of [TRI], both of which were contemplated under the Letter of Intent."). Notwithstanding the fact that Ciarletta's counsel recognized that Ciarletta could not vote the Shares until they were transferred into its name, Ciarletta took no action to compel the Debtor to endorse the Shares over to it prior to the filing of this bankruptcy case. Similarly, Ciarletta did not seek relief from the automatic stay to compel the endorsement of the Shares or, if its ultimate goal was to replace the Debtor as the controlling officer of TRI, Ciarletta did not seek the appointment of a chapter 11 trustee in either the Debtor's case or in TRI's case. Thus, instead of coming before the Court on notice to other interested parties in these related bankruptcy cases, Ciarletta simply exercised self-help in violation of the automatic stay.

It is undisputed that Ciarletta had actual knowledge of the Debtor's bankruptcy case at all times relevant to the Motion. Thus, the Court concludes that Ciarletta's violation of the automatic stay was willful.

While the Debtor sought actual and punitive damages in the Motion for Ciarletta's willful violation of the stay, the Debtor limited its relief at the hearing to a request for reimbursement of the attorneys' fees he incurred in bringing the Motion. Counsel for Ciarletta stipulated that a reasonable attorney fee for prosecuting the Motion is $4,100.00.

Thus, in sum, the Court concludes that (i) Ciarletta had no right to vote the Shares because the Shares were not transferred into its name, (ii) Ciarletta's attempt to vote the Shares and replace the Debtor as the president and sole director of TRI violated the automatic stay in the Debtor's case, (iii) Ciarletta's violation of the automatic stay was willful because it had actual knowledge of the Debtor's bankruptcy case, and (iv) the Debtor is entitled to recover the reasonable attorneys' fees he incurred in prosecuting the Motion in the amount of $4,100.00 from Ciarletta.

A copy of the Court's Order granting the Motion is enclosed. This letter ruling and the Order were forwarded to the Clerk's office today for filing.

Sincerely,

Barbara Houser

Barbara J. Houser
United States Bankruptcy Judge

Enclosures

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

IN RE:	§	
	§	
ROBERT J. HUTCHISON,	§	**CASE NO. 01-46374-BJH-11**
	§	
	§	
Debtor.		

ORDER ON MOTION FOR ORDER ENFORCING AUTOMATIC STAY AND AWARDING DAMAGES FOR VIOLATION OF STAY

Before the Court is the Motion by Robert J. Hutchison (the "Debtor") For Order Enforcing Automatic Stay and Awarding Damages for Violation of the Automatic Stay. For the reasons set forth in the letter ruling entered concurrently with this Order, the Court concludes that the Motion should be granted. Therefore, it is

ORDERED that the Motion is **GRANTED**; and it is further

ORDERED that the Debtor recover from Ciarletta & Associates, Inc. the sum of $4,100.00 as reasonable attorneys' fees incurred in prosecuting the Motion.

SIGNED: January 18, 2002

Barbara Houser

Barbara J. Houser
United States Bankruptcy Judge